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**TESTIMONY OF MASSACHUSETTS ATTORNEY GENERAL MARTHA COAKLEY  
REGARDING AUCTION RATE SECURITIES**

**Thursday, September 18, 2008**

Thank you for inviting me to testify here today. I am Massachusetts Attorney General Martha Coakley. Our Office, along with the Secretary of State of the Commonwealth, provides public enforcement of securities laws at the state level in Massachusetts. The Attorney General's Office is authorized to bring criminal and civil actions in our State Courts against investment banks, brokers, and issuers who deceive investors or fail to meet required legal standards. Our Office also has exclusive authority to bring actions under our State False Claims Act against entities that mislead towns, cities, and other state entities regarding investment decisions.

Auction rate securities sold in Massachusetts have been a great concern to us. As you know, these securities are debt and debt-like instruments, such as a bond or preferred stock, for which the interest rate or dividend is periodically reset through an auction mechanism. Although these securities have long-term maturities of many years, they historically have been offered for sale at weekly or monthly auctions, which provided the appearance of periodic liquidity. Because of this supposed liquidity, auction rate securities were often touted as being so-called "cash alternatives." When earlier this year the market for auction rate securities dried up, the auctions through which they were sold experienced widespread failures. These failures largely eliminated liquidity, making it difficult to dispose of the securities at all. When the securities were then written down to reflect their reduced market value, many investors suffered serious losses in their investment principal.

Responding to allegations of misleading sales practices, we began to review auction rate securities last year after certain mortgage-linked auction rate securities experienced failed auctions in August of 2007. In early 2008, Secretary of State William Galvin requested that our two Offices divide responsibilities. Our Office concentrated on sales to towns, cities and state entities under our False Claims Act authority, while the Secretary performed an administrative regulatory review of retail sales as part of a national North American Securities Administrators Association (NASAA) task force. Our Office served investigative subpoenas, met with affected municipalities, reviewed documents, and took testimony from investment banks and their agents. Our review focused on whether state entities, as customers, were misled regarding the appropriateness of auction rate securities as investments. We carefully scrutinized broker behavior, disclosures, as well as the lack of disclosure, and the behavior of investment banks as they sought to transfer auction rate securities from their own accounts to those of their municipal customers. We performed our investigations thoroughly but quickly, and obtained prompt results.

Six weeks after starting our review of the investments of Springfield, Massachusetts, (and just days before the broader market for auction rate securities began to meltdown) we recovered from Merrill Lynch at par the \$14 Million that the city had invested in auction rate CDO securities. In our review of UBS, which we initiated the same day UBS began letting its auctions fail, we completed our investigation in approximately 10 weeks and recovered \$37 Million for 18 Massachusetts municipalities and state entities (we later recovered additional monies from UBS, including repayments to town trusts holding third party monies and a \$1 Million payment to the state including fees and costs). We began our review of Morgan Stanley in the same time frame, which resulted in the recovery of an additional \$2 Million for towns and cities. Most recently, our ongoing review of Citibank resulted in Citi's agreement to return \$20 Million to the Massachusetts Water Pollution Abatement Trust. Our recovery against Merrill was the first recovery by a state in the auction rate arena, and our consent judgment against UBS was the first court ordered resolution by a public enforcer. We believe our early investigative and litigation efforts helped jump-start the broader resolution process, and we commend the good work of Secretary Galvin,

Attorney General Cuomo in his role as New York's administrative securities regulator, the SEC, NASAA, and FINRA, for the roles they are playing in moving the larger process forward.

I commend this Committee for looking closely at the auction rate securities market, and for trying to find ways to help investors and issuers. This is complicated, and it is important to ensure that all solutions reached will provide relief for investors and the entities that issued the auction rate securities. I would like to make three suggestions to the Committee:

1. Any solution should actually return full investment amounts to all investors.
2. The monies must be returned promptly.
3. Non-profit and governmental issuers should also not be forced to incur additional expenses and losses as a result.

Additionally, the Committee should focus on the larger picture and address the problems with the underlying assets backing some of these securities.

1. On the initial matter of restitution, it is important that we seek to provide full par value payments to all investors, and to cover any losses that those investors suffered. In our cases, we have achieved this goal, obtaining full recoveries for the affected Massachusetts entities. However, voluntary buy-back initiatives or liquidity solutions proffered unilaterally by the investment banks have not provided full restitution. And, although the regulatory settlements announced by the SEC and state administrative regulators have obtained promises to repay some investors at par, other investors have not been provided any repayments at all. Our Office recently experienced this first-hand, when we learned that our Massachusetts Water Pollution Abatement Trust, which held \$20 Million in Citi's auction rate securities, was not actually covered by the widely announced regulatory settlement between NASAA and Citibank. In conjunction with our investigation under the state False Claims Act, we had to separately negotiate with Citi to return those monies. Municipal governments must keep substantial operating

reserves in cash accounts and were frequently persuaded to place such monies into auction rate securities with supposedly “guaranteed” liquidity by the very entities now settling with other regulators. So-called “global” settlements that do not return monies to towns, cities, and state trusts fail to protect the public fisc. These entities provide vital public services, and citizens are shortchanged when local and state governmental investments are left to suffer losses. Similarly, while the regulatory settlements may help many well- heeled individual investors, they fail to help investors of more modest means who may have invested unwittingly in auction rate securities through their mutual funds. Such individuals should not be left uncompensated.

2. The second issue is timing. Large scale securities cases do not always have the best track record for getting monies back to investors in a timely manner. In situations where investors were led to believe they would have regular access to their cash through weekly or monthly auctions, it is crucial that any repurchases happen promptly. I urge this Committee to consider this issue of timing, and take steps to ensure that any resolution happens with all deliberate speed.

3. There is another side to the auction rate issue beyond the harm to investors. The failure of this market has also caused significant harm to numerous non-profit and governmental issuers. Many of these entities, including the issuers of student loans, medical care entities, and governmental subdivisions, are now facing potentially crippling costs as they restructure or reissue their debt. Many issuers, by the terms of their auction rate issuances, must offer high default interest rates to investors because the auction markets have failed. To avoid these costs, issuers must restructure or reissue their debt, thus incurring additional investment banking expenses. Such payments divert money from the public fisc or from charitable institutions and prevent it from being used to serve the public good. I hope this Committee will review ways to lower the transaction costs for non-profit and governmental issuers or otherwise shift such costs to those who are most responsible for this crisis. This will allow our public issuers of debt to continue to provide their vital public services without unnecessary expense.

Finally, even if the Committee can find a way to fix the immediate auction rate problem, we still

need to consider the stability of the underlying assets that backed these notes. For example, certain auction rate securities were tied to questionable home mortgage loans. Many more are tied to student loans, a market that is currently experiencing significant upheaval. The packaging and re-purchase of these debts as securities presents challenges for the entire financial system. We should be careful to ensure that intermittent liquidity crises in financial markets and other problems that may arise with advances in financial technology do not disproportionately harm consumers – such as students and homeowners – who, through such innovations, have become subject to the whims of such markets. In resolving today’s crisis, we need to consider how we can prevent future crises as well. Only by acting to protect homeowners, students, and other borrowers, will we be able to prevent another similar crisis in the future.

Thank you again for the opportunity to testify before this Committee.

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